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November 24, 2003

BY HAND-DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001

Re: Finance Docket No. 34319
Consolidated Rail Corporation – Declaratory Order Proceeding

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are an original and ten copies of "Consolidated Rail Corporation's Rebuttal Argument." Please date-stamp the extra copy that is enclosed and return it to our representative. Also enclosed is a diskette containing the Rebuttal Argument in electronic format.

Sincerely yours,

Robert M. Jenkins III

RMJ/bs

Enclosures

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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34319

CONSOLIDATED RAIL CORPORATION –
DECLARATORY ORDER PROCEEDING

CONSOLIDATED RAIL CORPORATION'S
REBUTTAL ARGUMENT

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Dated: November 24, 2003

BEFORE THE

SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34319

CONSOLIDATED RAIL CORPORATION – DECLARATORY ORDER PROCEEDING

CONSOLIDATED RAIL CORPORATION'S REBUTTAL ARGUMENT

Pursuant to the Board's Decision served October 10, 2003 ("October 10 Decision"), Consolidated Rail Corporation ("Conrail") files herewith its Rebuttal to the Reply filed November 12, 2003, by AT&T Communications, Inc. ("AT&T"). There are three questions before the Board in this proceeding concerning the preemptive effect under 49 U.S.C. § 11321(a) of the Board's decision in *CSX Corp., et al. – Control and Operating Leases/Agreements – Conrail Inc., et al.,* 3 S.T.B. 196 (1998) ("Decision No. 89"). Conrail responds below to AT&T's comments on each of those three questions in turn.

1. **The Board Should Find That Any Claim Against Conrail For "Repudiating" The FOC License Agreement Is Preempted.**

AT&T has taken the position that its Complaint before the District Court does not challenge Decision No. 89 itself or "any aspect of the Transaction" the Board approved. AT&T Reply at 20-21. Instead, AT&T claims that it "merely included an *alternative* allegation that Conrail's announcement that it no longer would honor the MFN Covenant (to the extent it was implicated by the post-June 1, 1999 contracts) constituted a repudiation of the License Agreement." *Id.* at 19-20 (emphasis in original).

It is clear why AT&T has backed away from any argument that Conrail can be held liable for "divesting itself of the ability to perform its obligations." Compl. ¶ 39.d, attached as Conrail

Ex. 2 to Conrail's Opening Evidence and Argument. That claim is unquestionably precluded by Decision No. 89. *See Consolidation Coal Sales Co. v. Consolidated Rail Corp.*, STB Finance Docket No. 34169 (served May 24, 2002), slip op. at 6 (Conrail "simply cannot be held liable, under State law, for entering into a contract (here the 1997 [Transaction] Agreement) that contemplates a transaction (here, the CSX/NS/CRC transaction) that [the Board], acting under its exclusive authority under 49 U.S.C. 11323-25, [has] authorized [Conrail] to consummate."). The Board should take this opportunity to restate its holding in *Consolidation Coal,* so as to preclude any possibility that AT&T may argue at a future stage in this litigation that a basis for Conrail's liability is its inability to enforce the MFN clause as a result of Decision No. 89.

As to AT&T's "alternative allegation," it is clear that the Board's resolution of the second question before it, discussed next, will also resolve the question of whether any claim against Conrail for "repudiation" of the FOC License Agreement is preempted. *See* AT&T Reply at 19-20; *see also id.* at 20-21 ("Here, the repudiation lies in Conrail's affirmative refusal to accept any responsibility for reducing AT&T's fees if fiber optic contracts entered into [by CSX/NYC or NS/PRR] after June 1, 1999 charge its competitors less than the fees AT&T pays Conrail"). If the Board finds that Decision No. 89 preempts any claim against Conrail arising from its failure to apply the MFN Clause to FOC contracts separately entered into by CSX/NYC and NS/PRR along former Conrail right of way after the Split Date, then Conrail certainly cannot be held liable for "repudiating" the FOC License Agreement merely by announcing as much.

2. The Board Should Find That Decision No. 89 Preempts Any Claim Against Conrail Arising From The Application Of The MFN Clause After The Split Date To FOC Contracts Separately Entered Into By CSX/NYC And NS/PRR.

AT&T's argument on the second question before the Board is premised on AT&T's analysis of "key terms" of the Transaction and Operating Agreements. AT&T Reply at 8-13.

Based on that analysis, AT&T appears to argue alternatively that the Transaction and Operating Agreements gave Conrail the ability to control the FOC contracts entered into by CSX/NYC and NS/PRR on former Conrail lines or gave CSX/NYC and NS/PRR the ability and obligation to control the application of the MFN clause to their contracts. *Id.* at 22-24. Neither contention is factually accurate or legally supportable.

AT&T begins its analysis of "key terms" with the suggestion that as the "manager" of NYC and PRR, Conrail could control any FOC contracts independently entered into by CSX/NYC and NS/PRR after the Split Date, since the Operating Agreements provided that NYC and PRR must approve any new FOC contracts that CSX and NS enter into. *Id.* at 9. But Conrail does not and cannot exercise any such control. The fundamental purpose of the CSX/NS/Conrail transaction was a "procompetitive restructuring of rail service throughout much of the Eastern United States" under which CSX and NS would provide "vigorous" competition for each other. Decision No. 89, 3 S.T.B. at 247. Although CSX and NS did not acquire Conrail's assets directly, they did acquire independent control over the assets allocated to NYC and PRR. *See Consolidation Coal,* slip op. at 6 ("[E]ven though PRR is a Conrail subsidiary, it is controlled by NSC and is operated as a part of the NS rail system."); *see also CSX Corp., et al. – Control and Operating Leases/Agreements – Conrail Inc., et al.*, STB Finance Docket No. 33388 (Sub-No. 94) (served Nov. 7, 2003), slip op. at 5-6 ("The Supplemental Transaction [consolidating NYC within CSX and PRR within NS] will merely extend the existing rights of CSX and NS to control and operate NYC and PRR, respectively, to include full legal ownership of the properties and businesses of NYC and PRR."). Conrail has no knowledge, much less control, over the FOC contracts that CSX and NS may have entered into after the Split Date.

AT&T next suggests that NYC and PRR were obligated by Section 2.2(d) of the Transaction Agreement, and by the quitclaim deeds by which Conrail deeded over the allocated lines to NYC and PRR, to provide Conrail the information it needed to apply the MFN clause in the AT&T License Agreement to FOC agreements that CSX and NS independently entered into after the Split Date. AT&T Reply at 10-12. But AT&T's expansive interpretation is not supported by either the language or the purpose of these documents. Section 2.2(d) of the Transaction Agreement simply provided, with respect to agreements like the AT&T License Agreement that Conrail retained, that NYC and PRR would license or otherwise grant back to Conrail the property rights on the former Conrail lines that Conrail needed to continue administering those agreements. The quitclaim deeds between Conrail and NYC and PRR implemented Section 2.2(d) of the Transaction Agreement by providing for the reservation to Conrail of all "financial and property rights" in those agreements, including a "nonexclusive easement" for Conrail physically to access and administer the pertinent fiber optic facilities, so long as the easement did not interfere with "[NYC's or PRR's] right to grant other such nonexclusive easements or licenses within the [allocated lines]." AT&T Reply at 11 nn.3-4.

AT&T asserts that this and other similar language in the deeds require "[a]t a minimum . . . that NYC and PRR will do what is necessary to avoid interfering with AT&T's rights. For example, they would be required to ask Conrail where AT&T cable is buried so as to be sure not to cut or otherwise damage it." *Id.* at 12. Conrail does not disagree with this example of CSX/NYC's and NS/PRR's obligation not to physically interfere with Conrail's easement. But it does not follow from this unexceptional principle of physical non-interference that CSX/NYC and NS/PRR have an affirmative obligation, as AT&T next suggests, to disclose to Conrail the financial terms of the independent fiber optic contracts that they enter into after the Split Date (*id.*), much less that they place Conrail in a position to decide whether CSX/NYC's and NS/PRR's customers should be charged more than, less than, or the same as AT&T. *Id.* The straightforward language of the Transaction Agreement and the quitclaim deeds reserving certain property rights for Conrail simply will not bear this expansive interpretation.

AT&T's final recourse is to the "Best Efforts" clause in Section 8.2 of the Transaction Agreement. *Id.* AT&T suggests that this commonplace provision requiring the parties to use their best efforts to accomplish that to which they have agreed provides support for its interpretation of the rest of the Transaction Agreement. But AT&T's suggestion does nothing but assume what it is trying to prove. If the rest of the Transaction Agreement does not give Conrail the right to require CSX/NYC or NS/PRR to consult with Conrail about the independent prices they set for their own contracts on the allocated lines, then nothing in the "Best Efforts" clause requires such consultation.[1]

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[1] AT&T asserts that its interpretation of the Transaction Agreement is supported by Conrail's conduct during the STB approval proceedings, since Conrail did not notify AT&T that Conrail's ability to apply the MFN clause would be affected by the proposed transaction. AT&T Reply at 12. But no such notification was called for. *See* Decision No. 89, 3 S.T.B. at 329 n.198 ("agency approval of a rail merger confers *self-executing immunity* on all material terms of the transaction from all other laws to the extent necessary to permit implementation of the transaction") (emphasis added). The proposed transaction was well-publicized. All parties that had long-term contracts with Conrail were on notice of the impending changes. As the Board itself noted, "[t]he application has been endorsed by more than 2,700 parties, including more than 2,200 shippers, more than 350 public officials, and more than 80 railroads." *Id.* at 207. As for those that did not support the transaction as structured, well over 100 parties filed protests either opposing the transaction or urging the imposition of conditions. *See id.* at 207-13. AT&T complains that "if commercial contracts like the License Agreement are at risk under the STB approval process, then every commercial contract will be up for grabs" (AT&T Reply at 13 n.5), but only the enforcement of contract terms that conflict with the effectuation of the purpose of the transaction are preempted. *See, e.g., RLEA v. United States,* 987 F.2d 806, 814-15 (D.C. Cir. 1993). Since no such conflict is presented by the terms of most commercial contracts, few are preempted.

It bears emphasizing here as well that Conrail is not seeking a declaration of preemption of the entirety of the AT&T License Agreement, or even the entirety of the MFN clause. AT&T

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In the Argument section of its Reply, AT&T reprises its view that since NYC and PRR took the allocated lines "subject to" Conrail's retained easements, they have an obligation not simply to avoid physical interference with Conrail's easements, but to provide whatever information about CSX/NYC's and NS/PRR's independent contracts Conrail might need to comply with the MFN clause in the AT&T License Agreement. AT&T Reply at 23. Here, AT&T cites property law cases standing for the proposition that the "servient holder" has no right to use land subject to an easement in such a way as to interfere with the easement (*id.*), but this does not help AT&T's cause, since no one has suggested that CSX/NYC or NS/PRR is interfering with AT&T's quiet enjoyment of its fiber optic license or Conrail's administration of that license.

AT&T advances an alternative argument that, as Conrail's owners, CSX and NS could bypass Conrail and apply the MFN clause themselves. "CSX and NS are more than capable of deciding whether it is in their financial interest to obtain lower fees from AT&T's competitors and then reduce the fees that Conrail receives from AT&T, or refuse to charge less to AT&T's competitors in order to retain the full $17 million annual fee AT&T now pays Conrail." *Id.* at 22. But CSX and NS *compete* for fiber optic business not only with each other but also with Conrail. The Board did not authorize them to set prices for fiber optic licenses collectively, and neither CSX nor NS individually can decide what is in Conrail's financial interest.

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continues to operate its fiber optic system over 2700 miles of current and former Conrail lines, and the MFN clause has always been, and continues to be, enforceable with respect to all fiber optic contracts (save the unique Qwest "barter" agreement) that Conrail has retained, or has entered into since the Split Date.

Had the Transaction Agreement provided for the AT&T License Agreement to be allocated between CSX and NS, then AT&T's suggestion that each could independently apply the MFN clause to its post-Split Date contracts might make more sense. But that is not what the Transaction Agreement provided or the Board approved. The Transaction Agreement provided for Conrail to retain the AT&T License Agreement and administer it as a separate business venture, with no involvement by CSX's and NS's own separate and competing business ventures. Thus, AT&T's suggestion that "[t]hese parties [CSX, NS, and Conrail] easily can share the information required [to apply the MFN clause]" is simply wrong as a legal matter. *Id.* at 23.[2]

By the same token, AT&T's suggestion elsewhere in its argument that preemption is not "necessary . . . to carry out the transaction" within the meaning of Section 11321(a) is also wrong. Although AT&T at first appears to argue for the application of some sort of "blocking" standard (AT&T Reply at 15-17),[3] AT&T recognizes, citing *Consolidation Coal,* that "'the

[2] AT&T returns in the end of this section of its argument to its refrain that Conrail should not be permitted "to receive monies that are contingent on compliance with the MFN License Agreement terms" if it does not comply fully with those terms. AT&T Reply at 23-24. For the reasons set forth in Conrail's Opening Evidence and Argument (at 18-19), it is for the District Court, not the Board, to determine as a matter of state contract law the extent, if any, to which Conrail's right to receive payments under the FOC License Agreement is contingent on the application of the MFN clause to segments of the allocated lines where CSX/NYC or NS/PRR have negotiated their own fiber optic terms post-Split Date. Conrail does not believe as a matter of state contract law that such limited preemption requires or justifies altering the remainder of the FOC License Agreement, but the Board need not intervene in that contractual dispute, which is for the District Court to resolve.

[3] AT&T cites two cases to support its argument that a blocking standard should be applied. Neither of those cases is applicable here. *Harris v. Union Pacific Railroad*, 141 F.3d 740, 744 (7th Cir. 1998), involved a civil rights claim arising from the denial of certain benefits to two employees who were on maternity leave. And, despite AT&T's protests to the contrary, *City of Palestine, TX v. ICC*, 599 F.2d 408, 415 (5th Cir. 1977) has largely been repudiated. *Contrast* AT&T Reply at 16 n.6. While this Board has recently cited *City of Palestine*, it has been for the proposition that "pre-merger contracts not pertinent to the merger and acquisition are not

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Board has stated that the necessity test does not require a finding that the consolidation *could not go forward* without preemption of the law or contractual provision from which an exemption is sought.'" AT&T Reply at 17 (emphasis in original). *See also Swonger v. STB,* 265 F.3d 1135, 1141-42 (10th Cir. 2001) ("We agree that the necessity standard does not require a finding . . . that the merger could not be effectuated without the specific changes that are proposed."), *cert. denied,* 535 U.S. 1053 (2002). As the Board emphasized in *Consolidation Coal* (slip op. at 6), the issue is whether there is a "nexus" between the challenged law or provision and "the transportation benefits intended to result from the authorized transaction." *See also RLEA v. United States,* 987 F.2d 806, 814-15 (D.C. Cir. 1993) (the ICC "reasonably interpreted this standard to mean 'necessary to effectuate the purpose of the transaction'").

Here, the fundamental purpose of the transaction was to enable CSX and NS to "provide vigorous, balanced, and sustainable competition, each over approximately 20,000 miles of rail lines in the East." Decision No. 89, 3 S.T.B. at 247. This required more than just the allocation of rail lines between CSX and NS. It required the allocation of vast amounts of equipment, property rights, and contracts related to those lines. Among the rights involved were the rights to enter into fiber optic license agreements along the allocated lines, which were significant enough that the parties made special provision in the Transaction Agreement and the Operating Agreements for the treatment of those rights. In order to ensure their independent operation,

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exempted under 49 U.S.C. 11321." *See Township of Woodbridge v. Consolidated Rail Corp.*, STB Docket No. 42053 (served Dec. 1, 2000), slip op. at 5 n.12. But that citation is not relevant to the question of whether only contracts that *block* a transaction are preempted. Post-*Train Dispatchers* caselaw, as well as this Board's own precedent, answers that question in the negative. *See Consolidation Coal*, slip op. at 6; *Swonger v. STB*, 265 F.3d 1135, 1141-42 (10th Cir. 2001), *cert. denied,* 535 U.S. 1053 (2002).

CSX and NS were given complete and independent control over the allocated lines, including the right to enter into their own fiber optic contracts for their own competitive business reasons. Conrail does not interfere with their competing business decisions, and nothing in the Transaction Agreement or Decision No. 89 permits it to do so. Any effort by Conrail to apply the MFN clause to the FOC contracts that CSX and NS have entered into or may wish to enter into after the Split Date would fly directly in the face of the competitive structure of the transaction approved by the Board, and any contractual interpretation that would hold Conrail liable for its inability to apply the MFN clause to those contracts must accordingly be preempted.

3. The Board Should Find That Application Of The MFN Clause To The Qwest Barter Contract Is Preempted.

The third issue before the Board concerns whether application of the MFN clause to the Qwest "barter" contract that Conrail entered into in 1996 is preempted after the Split Date by virtue of the fact that the approved division of most of Conrail's assets between NYC and PRR rendered it impossible for Conrail to make use of Qwest's services. As an initial matter, AT&T suggests that since Conrail has only discussed the Qwest contract, the Board should not attempt to address the generic question of "impossibility" and "commercial impracticability" framed by the third question as is it is written. *See* AT&T Reply at 24-25 & n.13. We agree. All that the Board need decide is the specific question that the parties dispute – whether AT&T's attempt to apply the MFN clause to the Qwest barter contract post-Split Date is preempted.

The answer to that straightforward question is yes. According to AT&T, the MFN value of the Qwest barter contract was to be determined by the use of Qwest's fiber optic capacity to run Conrail's systemwide rail operations.[4] But even assuming *arguendo* that AT&T's method of

[4] Both parties' arguments here concerning the Qwest contract presume that AT&T can value the contract for MFN purposes on a present-day basis. Conrail disputes that AT&T can so (cont'd)

valuation were correct, the transaction approved in Decision No. 89 resulted in a significant reduction in the size and scope of that system and Conrail's operations, thus decimating the value of the Qwest barter contract to Conrail. AT&T now seeks a literal free ride by arguing that it is entitled to the same "deal" as Qwest. AT&T's Reply never comes to grips with why this is justified. It does not even attempt to explain why it should have free use of its fiber optic cable merely because Conrail has been precluded, by Decision No. 89, from using Qwest's fiber optic capacity.

The arguments that AT&T does present in its Reply are unavailing. First, AT&T argues that Conrail entered into the Qwest contract in 1996, "well before it entered into the Transaction Agreement and sought the Board's approval of the Transaction." *Id.* at 24. That is true, but it cuts in Conrail's favor. Nobody anticipated in 1996 that Conrail's assets would be divided for operation by CSX and NS. AT&T asserts further that Conrail entered into an "open ended agreement" and "ran the risk that it would not need Qwest capacity." *Id.*; *see also id.* at 25 ("Conrail voluntarily accepted the risk that it might not need the communications capacity that Qwest agreed to provide"). But the same could be said of virtually *any* long-term contract that Conrail entered into. In particular, that same argument could as easily have been made regarding the twenty-year agreement that Conrail negotiated with the Consolidation Coal Sales Company in 1991. *See Consolidation Coal*, slip op. at 1. There the Board properly preempted application of that contract's minimum fee provision post-Split Date, because Decision No. 89 had made it

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apply the MFN clause to the Qwest contract, and instead believes that the appropriate application of the MFN clause would value the Qwest contract based on the value of the Qwest capacity to Conrail at the time the parties entered into the agreement – in 1996. However, the proper method for applying the MFN clause to the Qwest contract is a state contract law question that the Board need not, and should not, decide.

impossible for Conrail to use Consolidation Coal Sales' services. *See id.* at 5. The result should be the same here.[5]

AT&T similarly argues that "the parties to the Transaction could have made arrangements for PRR and NYC to make use of the fiber optic capacity provided by Qwest to the extent they concluded that such use might insulate Conrail from liability under the MFN Covenant." AT&T Reply at 25. But granting NYC/CSX and PRR/NS the right to use the Qwest fiber optic capacity (see Transaction Agreement § 2.2(d), attached as Conrail Ex. 1 to Conrail's Opening Evidence and Argument) does not mean that they will actually use that capacity. Conrail cannot force CSX and NS to use Qwest capacity at all, much less to the same extent as Conrail would have had most of its assets not been allocated to NYC and PRR. The value that the Qwest contract had to an integrated Conrail system around which it was built cannot be replicated on two disparate and much larger systems for which it was not designed at all.

Finally, AT&T argues that Conrail can "perform[ ]" the contract by reducing AT&T's fees. AT&T Reply at 25. But the issue here is not whether Conrail *can* pay damages and/or reduce its fees. Whether Conrail has the financial capacity to give AT&T a huge windfall is irrelevant. *See Consolidation Coal*, slip op. at 6 n.5 ("insolvency is not a requirement for the protection of § 11321(a)"). The issue is whether Conrail *should* be required to pay damages and/or reduce its fees when Decision No. 89 has made it impossible after the Split Date for Conrail to realize the value of the Qwest contract that forms the basis of AT&T's demand. Since

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[5] AT&T alleges that "Conrail cannot dispute that it did not use any Qwest capacity before the right of way transfer." AT&T Reply at 25. But Qwest did not complete the installation of its fiber optic system until 1999. Thus, as a practical matter, Conrail was precluded from using the Qwest capacity pre-Split Date. In any event, Conrail's alleged non-use of the Qwest capacity pre-Split Date is not an issue before the Board, because Conrail is not seeking to preempt any of AT&T's pre-Split Date claims.

Conrail's disability in this regard is a direct consequence of the approved transaction, the Board should find that AT&T's claim is preempted under Section 11321(a).

Conclusion

For the foregoing reasons, the Board should find that AT&T's claims against Conrail are preempted as set forth above.

Respectfully submitted,

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Dated: November 24, 2003

CERTIFICATE OF SERVICE

I hereby certify that on this 24th day of November, 2003, I caused copies of the foregoing Consolidated Rail Corporation's Rebuttal Argument to be served by hand upon:

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